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IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

No. 243

ESTATE OF WALTER F. RAU, SR., Deceased; RAYMOND J. SHORB, Administrator with the Will Annexed,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

REPLY BRIEF

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JURISDICTION

The judgment of the Court of Appeals for the Ninth Circuit was entered on March 9, 1962 (Pet. Appendix A, page 11a). Petition for a Writ of Certiorari was filed on July 12, 1962. Brief in opposition was filed by Respondent on August 28, 1962. Jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the Court of Appeals correctly decided that the fraud penalty provided for in Section 293(b), Internal Revenue Code of 1939, imposed subsequent to taxpayer's death, survives his death in the absence of statutory provisions authorizing its imposition.

2. Whether the Court of Appeals erroneously construed Section 41, Internal Revenue Code of 1939, as applied to the findings of fact by the Tax Court of the United States.

3. Whether the Court of Appeals erred in sustaining the finding by the Tax Court that the evidence of fraud was clear and convincing.

STATUTES INVOLVED

Internal Revenue Code of 1939, Section 293—Addition to the Tax in Case of Deficiency (b) Fraud. "If any part of any deficiency is due to fraud with intent to evade tax, then fifty percentum (50%) of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected and paid in lieu of the fifty percentum (50%) addition to the tax provided in Section 3612d(2).

Section 1112, Internal Revenue Code 1939—Burden of proof in fraud cases:

> "In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the Commissioner".

Internal Revenue Code, 1939, Section 41. General Rules.

> "The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be), in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if any such method of accounting has been so employed or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as

in the opinion of the Commissioner does clearly reflect the income.

"If the taxpayer's annual accounting period is other than a fiscal year as defined in Section 48, or the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis on the calendar year."

STATEMENT

Assuming arguendo, the credibility of Webb and Goldstein, a critical analysis of their testimony, demonstrates, quite clearly, the superiority of the data contained in the net worth to which the parties stipulated. This may be illustrated by considering the facts in the order in which they appear in Respondent's statement.

Re: *Understatement of gross income and charging of fictitious expenses and purchases.* The effect of either or both of the above is to decrease the net taxable income as reported in decedent's tax returns. The only asset inuring to the direct benefit of decedent would be that of cash. Exclusive of other assets, the net worth statement accounts for nearly $90,000.00 in cash as of December 31, 1947 (joint exhibit 1-A).

Re: *Withholding of receipts of cafe and bar varying from $10.00 to $200.00.* As to this testimony by Webb and Goldstein, neither of them testified that such sums were not ultimately deposited in decedent's bank accounts. Of singular significance is the fact that the acceptance of such evidence compels the assumption that approximately $131,000.00 in cash, exclusive of decedent's bank accounts, was in decedent's possession at his death, a fact that has never been established by any evidence whatsoever. (Webb made deposits three or four times each day. (R. 24, 141, 145, 148, 161)

Re: *Increasing deposits by arbitrary amounts.* By increasing deposits in excess of receipts, decedent's cash, from whatever source, is automatically reflected in the net worth. It should be noted that, contrary to the finding of the Tax Court, Webb did not state that these additions were made for the purpose of making "receipts" look respectable. He actually stated that such additions were made to make the "deposits" look better. (R. 279-281)

Re: *Duplication of purchases.* The fact that purchases were overstated (this adjustment was originally made in the statutory notice of deficiency and repeated by the Commissioner in its amended answer seeking additional increased deficiencies) has no effect whatsoever upon the net worth. This is true for the reason that the net worth contains adjustments for opening and closing inventories at the end of each of the years in question.

Re: *Close supervision maintained by decedent.* Although the Tax Court found, as a fact, that decedent maintained a close inspection of the books and records of the French Cafe and Southern Bar, checked on the daily receipts and disbursements of these businesses, etc., it could have only done so by ignoring the testimony of Betty Dorsey who attended decedent on twenty-four hour duty, from the latter part of 1945 until his death in January, 1953. She testified that decedent was subject to spells of weeping and that he did not seem to have any interest in his businesses. (R. 589, 590, 593, 595, 602, 604, 607, 609-11) There was also expert testimony, based on a long history of alcoholism, that decedent was incapable of supervising his business in a rational manner. (R. 415) There

was other medical testimony establishing that decedent was an alcoholic, afflicted with thrombophlebitis, myocarditis and neuritis. (R. 392-94 and 403)

Re: *Specific items being more accurate guide than net worth.* First of all, there is no authority for the proposition that oral testimony, elicited twelve to seventeen years later, constitutes "specific items" as that term is understood in determining taxable income. Notwithstanding the Tax Court's acceptance of oral testimony, as "speeific items," nothing contained therein warrants the rejection of the net worth as stipulated between the parties. This, it is submitted, has been amply demonstrated by the foregoing analysis. This finding by the Tax Court, therefore, is arbitrary as a matter of law for the reason that it lacks substantial evidence for its support.

ARGUMENT

1. In citing *Helvering* v. *Mitchell,* 303 U.S. 391, Respondent ignores the fact that this decision did not involve the question of survivability of the penalty provided by Section 293(b) Internal Revenue Code, 1939.

This, of course, is the basic issue which, in Petitioner's view, requires clarification by this Court. The fact that the various Courts of Appeal, as well as the Tax Court of the United States, have followed the administrative ruling of the Commissioner of Internal Revenue prompted the filing of this petition. While petitioner concedes the absence of conflict of decisions concerning the question of survival of the fraud penalty, there are, however, conflicts as to whether the penalty contained in Section 293(b), Internal Revenue

Code of 1939 is penal or is merely an addition to the tax and remedial in nature. As an example of this conflict, the Court of Appeals for the Eighth Circuit, in 1952, construed Section 293(b), Internal Revenue Code of 1939 as providing for a *fraud penalty, Owens* v. *U.S.*, 197 Fed. 2nd, 450; in the case at bar, however, reported at 301 Fed. 2nd, 51, the Court of Appeals for the Ninth Circuit, without expressly construing Section 293(b) Internal Revenue Code of 1939, disposed of this issue by simply stating that, "we feel that the taxpayer's wrongful act is in the nature of an injury to the property of the United States". It then concluded that the "addition" should be upheld. This decision, it is submitted, not only conflicts with that of the Eighth Circuit in *Owens* v. *U.S., supra,* as to the nature of the penalty provided for in Section 293(b) Internal Revenue Code of 1939, it further complicates the question of survivability. A cursory reading of the opinion of the Court below, leaves no doubt that its decision would have been otherwise except for a newly conceived notion that the taxpayer's wrongful act was in the nature of a tort. By so doing, the Court avoided the problem of construing Section 293(b). When analyzed, however, it becomes quite clear that the decision of the Court below holds, in effect, that a tax statute may operate upon an act defined as one "in the nature of the injury to the property of the United States". If, as the Court below feels, the taxpayer's wrongful act is in the nature of an injury to property, redress does not lie in proceedings before the Tax Court of the United States which has no jurisdiction over claims of this character. Unless and until this Court deals directly with the question of survival of the fraud penalty, doubt and uncertainty will persist.

2. As previously illustrated, the oral testimony upon which the Tax Court relied, assuming its reliability, has no effect whatsoever upon the net worth method. That which has been overlooked by the Tax Court, and also by the Court of Appeals, is that the alleged understatement of income and the overstatement of deductions is nothing more than an *explanation* for the increase in decedent's net worth; indeed, Petitioner has consistently urged throughout this proceeding that Webb's and Goldstein's testimony merely corrobates the net worth as stipulated. By its findings, the Tax Court has, in reality, superimposed computations resulting from oral testimony, upon the stipulated increase in decedent's net worth. There can be no justification for so doing, and Respondent's argument that the Tax Court relied upon "direct proof" is mere sophistry; the net worth is also proof, and it is equally direct. Furthermore, under the rules of the Tax Court (Rule 31(b)(1)), that Court expects the parties to stipulate the evidence to the fullest extent; the parties hereto complied with that Rule. In the absence of fraud or mutual mistake, stipulations are binding upon the parties, *Brinson* v. *Tomlinson*, 264 Fed. 2d 30, C.C.A. Ninth, decided February 26, 1959.

3. As to the question of fraud, Petitioner relies upon the arguments advanced in its Petition and the cases therein cited (pages 12 and 13). Petitioner also relies upon the fact that Webb and Goldstein were the actual operators of decedent's businesses over which they exercised full control (R. 57, 108, 121, 122, 137, 145, 148, 161, 209, 439, 440 and 476); this factor, coupled with undisputed evidence concerning their extraordinarily large financial transactions, creates

considerable doubt that Respondent has established fraud by clear and convincing evidence.

CONCLUSION

For the reasons hereinabove stated, this Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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